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CIA/RR CB 65-51
September 1965

Copy No. 258

INTELLIGENCE BRIEF

SOME IMPLICATIONS
OF THE INADEQUATE SOVIET WHEAT HARVESTS

DIRECTORATE OF INTELLIGENCE
Office of Research and Reports

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W A R N I N G

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SOME IMPLICATIONS
OF THE INADEQUATE SOVIET WHEAT HARVESTS

The failure of Soviet agricultural policies was dramatized again this August, when a sharp drop in wheat production forced the USSR to contract for the purchase of almost 7 million metric tons (mt) of wheat and flour from Free World suppliers for delivery in the 1965/66 crop year. The cost of these recent purchases is almost \$500 million. Even if the USSR purchases no more grain before 1 July 1966, its foreign exchange outlay for grain in the past three years will amount to \$1.5 billion.

To pay for these imports, the USSR has resumed selling gold and appears to be cutting back on imports of machinery and equipment from the West. At the same time, Soviet industry is badly in need of Western technology to assist in stemming the recent decline in the effectiveness of investment and the consequent marked slowdown in economic growth. Since 1960 the USSR has faltered badly in its drive to overtake the US economy -- indeed, the absolute gap has widened in favor of the US -- and the Brezhnev-Kosygin regime no longer gives publicity to the goal of "overtaking and surpassing" the US, perhaps because of a more realistic view of Soviet prospects.

The timing of the new wheat purchases is awkward for the Soviet leaders. They are currently engaged in the final shaping of the new Five Year Plan (1966-70) and in attempting to resolve the conflicts in resource allocation which have been heightened by the escalation of the war in Vietnam, the challenge of US space programs, the need to achieve self-sufficiency in food production, and the search to find investment resources to shore up the sagging economy.

The present agricultural failure, because of its widespread effects on domestic and foreign policy, could increase tensions among the members of the collective leadership. The regime as a whole probably has no desire for major overhauls of resource allocation or of economic institutions, but the need is urgent. Recent agricultural events reflect a basic strategic vulnerability of the USSR, not merely a threat to the present welfare of its people. Thus the hands of leaders or potential leaders who propose or may propose radical solutions to Soviet problems probably have been strengthened.

C-O-N-F-I-D-E-N-T-I-A-L

I. Introduction

The recent purchase of almost \$500 million worth of wheat (7 million mt) from the West is another dramatic manifestation of the chronic failure of Soviet agricultural policies. The recent expenditure follows a Soviet outlay of about \$200 million for wheat in the 1964/65 crop year (July-June), in spite of an above-average harvest during that period, and of nearly \$830 million in the 1963/64 crop year following the 1963 grain disaster. Even if there are no further Soviet grain purchases in the current grain year (1965/66), the USSR will have paid Western suppliers an unprecedented \$1.5 billion in three years to feed its population. Moreover, the Soviet diet remains a dull one by Western standards -- heavily weighted with grains and potatoes.

The foreign exchange loss from the grain purchases will directly limit future Soviet imports of Western machinery and equipment. The technical superiority of such imports is of key importance to the USSR in its effort to modernize industry and improve living standards while still funneling the best of its own technical resources into military and space development.

II. Impact on Imports of Machinery and Equipment from the Industrial West

The foreign exchange burden of these grain purchases is reflected in the trend of new contracts placed in the Free World for machinery and equipment. In 1963, reported contracts for machinery were valued at \$554 million, in 1964 they fell to \$319 million, and as of 31 August 1965 they stood at only \$170 million. Unless new orders for machinery and equipment rise sharply in the near future, the current level of machinery imports from the West (about \$600 million in 1963 and again in 1964) cannot be sustained. The types of machinery most desired by the USSR have a long production leadtime. For example, orders for chemical equipment accounted for about two-thirds of total contracts placed in 1965 and usually required the Western supplier to manufacture equipment for a complete plant.

Since the purchases of grain in early August and the concomitant renewal of large-scale sales of gold, the USSR has not placed significant additional orders for machinery in the West. During August 1965 there were two major contracts under consideration. One of these involved a huge petrochemical complex, estimated to cost \$150 million to \$250 million, to be supplied by a consortium of 23 companies in West Germany and France, headed by Salzgitter of West Germany. Negotiations on this

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C-O-N-F-I-D-E-N-T-I-A-L

complex had been renewed in the early spring of 1965 after a lapse of more than a year. In addition, the recent Soviet agreement in principle with Fiat of Italy to cooperate in the production of automobiles was expected eventually to result in contracts in the neighborhood of \$500 million. Now these potential orders may not be placed; at a minimum they are likely to face protracted delays.

III. Soviet Technology, Machinery Imports, and Economic Growth

Soviet technological inadequacy is highlighted most dramatically by the current strident press campaign for "raising the quality of Soviet products to world levels." For many decades, enterprise managers, under the relentless goading of the economic plans, concentrated on increasing the output of a limited range of standardized products. This policy of building more capacity in the metals, fuel, and standardized machinery industries served the Party objective reasonably well in the 1950's. But in the 1960's, there has been a declining trend in the effectiveness of investment and a markedly slower growth as the Soviet leaders have tried to transform their economy from one based on coal and steel to one with a chemical-electronics base. The slowdown in Soviet growth contrasted painfully with a renewed burst of growth in the US. Whereas in the 1950's the growth of Soviet GNP averaged some 6-1/2 percent annually, or nearly twice that of the US, since 1960 the average growth rates in the two countries have been about equal, with the result that the absolute gap between the sizes of the two economies has widened in favor of the US.

Recognizing the key role of technology, Khrushchev in 1958 sponsored programs of shifting emphasis to technologically advanced industries -- modernizing and diversifying through automation, more rapid replacement of obsolete equipment, and high-speed special-purpose machines to replace general-purpose machines. The modernization program has produced a high percentage of failures, primarily because of technological inadequacies and the traditional emphasis on quantity as opposed to quality. A host of badly designed new products are chronically beset by breakdowns, shortages of spare parts, and higher costs. Product quality thus far has not responded to exhortations. The demand for spare parts for agricultural machinery was so great that a number of specialized spare parts plants were built. Nevertheless, agricultural machines as well as the spare parts are still riddled with defects, and the number of unrepaired machines remains as large as ever.

Khrushchev's palliative was to draw down Soviet gold reserves in order to pay for advanced types of equipment from Western suppliers. As a consequence, Soviet imports of machinery from the Free World tripled between

1958 and 1962. Given the prospect that payments for the recent grain purchases could, by 1966, force Soviet gold reserves to a new low for the past decade, and given the more conservative nature of the Brezhnev-Kosygin policy with respect to imports from hard currency countries, the Khrushchev solution apparently will not be adopted by his successors. Partly as a result of this policy, there will be a continued lag in the rate of introduction of new technology in Soviet industry and consequently greater difficulties in attempting to revive the flagging rate of economic growth.

Should Soviet growth rates remain unimpressive, the propaganda image of Communism as the "wave of the future" will be further tarnished. The absolute size of the gap between the economies of the US and the USSR will continue to widen in favor of the US, and the Soviet leaders will lose ground in their self-appointed drive to "overtake and surpass" the US. It is significant that the new regime has not hinted at endorsing the goal of catching up with the US, perhaps because of a more realistic view of Soviet prospects.

IV. Effects on the Resource Allocation Problem

The timing of the recent purchase of grain is awkward from the standpoint of the Soviet leadership. It comes at a time when the leaders are engaged in the final shaping of the new Five Year Plan (1966-70) and are considering economic reforms. Difficult questions have been tabled by the course of events -- whether to raise military expenditures as a result of Vietnam; how to meet the challenge of US space programs; where to find the investment resources to shore up the sagging economy; and how to live up to a number of promises made to consumers on improving the supplies of food, consumer durable goods, and housing.

At the very least, the poor 1965 wheat crop will make it difficult for other priority claimants to receive additional funds at the expense of the ambitious agricultural program unveiled by Brezhnev in March of this year. This program, through a combination of higher farm prices and additional machinery and other inputs, was estimated to cost considerably more than the nearly \$80 billion* of direct planned investment for agricultural purposes during the period 1966-70. If defense maintains its present priority, the investment most likely to be cut is that in nondefense industry (other than that necessary for agricultural support).

* Seventy-one billion rubles converted at the official rate of exchange.

The present regime apparently feels some urgency in improving the lot of the Soviet consumer. This concern is vividly illustrated by recent purchases of equipment abroad, despite the very tight foreign exchange position. About 66 percent of the chemical equipment for which new orders were placed in 1965 was for consumer-oriented synthetic materials plants. In addition, the discussions with Fiat on cooperation in greatly increasing Soviet automobile production indicated a serious intention to break with Khrushchev's policy of "no automobiles."

V. Stability of the Collective Leadership

The present agricultural failure, because of its widespread effects on domestic and foreign policy, could increase tensions among the members of the collective leadership. The regime as a whole surely does not want to reopen the question of agricultural allocations or of major organizational overhaul at this time, but the need is urgent. To be without grain reserves after the above-average harvest of 1964 and to be forced again to reduce gold reserves represent a strategic vulnerability of the USSR, not merely a threat to the present welfare of its people. The failure of agriculture (and, to a lesser but important extent, of the economy as a whole) to respond to present programs strengthens the hands of those who are now making radical proposals for change, such as a sweeping reorganization of the central administrative apparatus or a shakeup of the kolkhoz system of collective farming. Unresolved problems increase the likelihood of leaders with radical programs coming to the fore. The direction that these changes might take is unpredictable, however, since it would depend on political infighting and highly subjective political judgments.

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Implications of the Inadequate Soviet Wheat Harvests (CONFIDENTIAL) ---
September 1965

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17 September 1965

MEMORANDUM FOR: Chief, Dissemination Control Branch, DD/CR
FROM : Acting Chief, Publications Staff, ORR
SUBJECT : Transmittal of Material

It is requested that the attached copies of CIA/RR CB 65-51, Some Implications of the Inadequate Soviet Wheat Harvests, September 1965, Confidential, be forwarded as follows:

State, INR Communications Center,
Room 6527, State Dept. Bldg.
Suggested distribution for
Embassies in Berlin, London,
and Moscow

25X1A



Attachments:

Copies #234 - #236 of CB 65-51

cc: CGS/RB

ACTION COMPLETED

The dissemination of this memorandum has been completed.

BY: *NOB*
Date: *20 Sept 65*

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3

Project No. 00. 5275

Report Series CIA/RR CB 65-51

Title: Some Implications of the Inadequate Soviet Wheat Harvests (Confidential)

Responsible Analyst and Branch [REDACTED] D/A 25X1A

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CB is confidential onlyIn attached request by USIA for use as
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SEP 10 10 35 AM '65

DATE: September 25, 1965

CENTRAL INTELLIGENCE AGENCY
INFORMATION REPORT

1. TO: CENTRAL INTELLIGENCE AGENCY
Chief, Liaison Division, DCI

25X1A

2. Requester's Name: [REDACTED]
Division: IS/WX

Extension: 3641
Ride and Room: 124, 1776

3. Information Report No. CIA/RR/CB-66-51
Classification: Confidential

Date: September 1965
Paragraph or See below

ILLEGIB [REDACTED]

4. Medium and/or medium in which sanitized version of report will be used.
If released: TBS column for use of field posts

Requested classification for sanitized version: Unclassified

5. Proposed Sanitized Version of Report:

In much as possible of the RR report entitled Some Implications of the Inadequate Soviet Wheat Harvests.

TO: [REDACTED] LS/CR 25X1A

If the second sentence of the first paragraph under II. page 2 is changed to read as follows, the brief may be used as unclassified without attribution to CIA:

"In 1963, reported contracts for machinery were valued at more than \$500 million, in 1964 they fell to about \$300 million, and as of 31 August 1965 they stood at less than \$200 million."

[REDACTED] 25X1A

Chief, St/P/C/RR

DO NOT WRITE BELOW THIS LINE. Use additional sheet of paper if necessary to
[REDACTED] 1776 No. 1

6. TO:

I. Approved/disapproved (as submitted/as modified on attached sheet). for
[REDACTED]

II. Comment/Action with the following explanation:

6 October 1965

MEMORANDUM FOR: Chief, St/P/C
THROUGH: Chief, ERA *W*
SUBJECT: Release of Current Support Brief to USIA

1. With reference to the request of USIA for unclassified use of CB 65-51, Some Implications of the Inadequate Soviet Wheat Harvests, the following changes in the text are proposed:

On page 2 of the CB, the second sentence of the first paragraph under II, should be changed to read:

"In 1963, reported contracts for machinery were valued at ~~\$554-million~~ more than \$500 million, in 1964 they fell to ~~\$319-million~~ about \$300 million, and as of 31 August 1965 they stood at ~~only-\$170-million~~ less than \$200 million."

Everything else in the CB may be considered unclassified.

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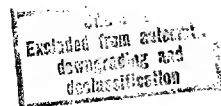
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CENTRAL INTELLIGENCE AGENCY
WASHINGTON D C 20505

OFFICE OF THE DEPUTY DIRECTOR FOR INTELLIGENCE

10 September 1965

MEMORANDUM FOR: *See Reverse Side

SUBJECT : Implications of Inadequate
Soviet Wheat Harvests

1. Earlier this week I sent you an intelligence memorandum on the USSR's faltering in its economic race with the U.S. You may also find of interest the attached related, but somewhat more narrowly focused, paper, "Some Implications of the Inadequate Soviet Wheat Harvests."

2. To pay for needed wheat purchased abroad, the USSR has resumed selling gold and appears to be cutting back on imports of machinery and equipment from the West. This comes at an awkward time for the Soviet leaders, and the present agriculture failure could increase tensions among them.

STATINTL

RAY S. LINE

Deputy Director for Intelligence

Attachment

CIA/RR CB 65-51

*Identical Memos sent to:

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